

An Overview of Pass-through Businesses in the United States

By Kyle Pomerleau

Economist

Key Findings

- Pass-through business income is taxed on the business owners' tax returns through the individual income tax code.
- Pass-through business income faces marginal tax rates that exceed 50 percent in some U.S. states.
- Pass-through businesses face only one layer of tax on their profits compared to the double taxation faced by C corporations.
- The number of pass-through businesses has nearly tripled since 1980, while the number of traditional C corporations has declined.
- Pass-through businesses earn more net business income than C corporations.
- Pass-through businesses employed more than 50 percent of the private sector work force and accounted for 37 percent of total private sector payroll in 2011.
- Although pass-through businesses are smaller than C corporations on average, they are not all small businesses. Many people work for large pass-through companies.
- The majority of pass-through business income is taxed at top individual tax rates.
- Tax reform aimed at improving the competitiveness of U.S. businesses needs to address the individual income tax code due to the economic importance of pass-through businesses.

Introduction

One of the goals of tax reform is to improve the competitiveness of U.S. businesses and grow the economy. A promising way to do that is by lowering taxes on saving and investment through business tax reform. Much time is devoted to improving the corporate side of the tax code, but corporate-only business tax reform misses a significant portion of business activity.

The United States currently has a large number of pass-through businesses, or businesses that pay their taxes through the individual income tax code rather than through the corporate code. These sole proprietorships, S corporations, and partnerships make up the vast majority of businesses and more than 60 percent of net business income in America. In addition, pass-through businesses account for more than half of the private sector workforce and 37 percent of total private sector payroll. Pass-through businesses are represented in all industries in the United States.

Given that pass-through businesses are a significant part of the U.S. economy, tax reform should address the individual income tax code along with the corporate tax code.

What Are Pass-through Businesses?

Table 1. Major Types of Pass-through Businesses

Legal Form	Description
Sole Proprietorship	An unincorporated business owned by a single individual that reports its income on schedule C of the 1040 tax form.
Partnership	An unincorporated business with multiple owners, either individuals or other businesses.
Limited Liability Company (LLC)	A type of business that has limited liability like a traditional C corporation.
S Corporation	A domestic corporation that can only be owned by U.S. citizens (not other corporations or partnerships) and can only have up to 100 shareholders.

Sole proprietorships, S corporations, limited liability companies (LLCs), and partnerships are also known as pass-through businesses (Table 1). These entities are called pass-throughs, because the profits of these firms are passed directly through the business to the owners and are taxed on the owners' individual income tax returns.

This is in contrast with traditional C corporations, which pay tax at the entity level through the corporate income tax. Their owners (shareholders) then pay tax on this income again when they receive a dividend or sell their stock and realize a capital gain.

Another difference between pass-through businesses and traditional C corporations is that owners of pass-through businesses pay the full tax on their business's income every year as the business earns it. Contrast this with owners or shareholders of C corporations, who can defer the taxation on their share of corporate income as long as the corporation retains its earnings or if the shareholder does not realize a capital gain on his stock.

What Taxes Do Pass-through Businesses Pay?

Since pass-through businesses pass their income and losses directly to their owners, these businesses face the same marginal tax rates as individuals. These rates start at 10 percent on the first \$9,075 of taxable income (\$18,150 married filed jointly) and rise to 39.6 percent on taxable income over \$406,750 (\$457,601 married filed jointly) (Table 2).

Table 2. 2014 Federal Income Tax Brackets and Rates, Pass-through Businesses

Rate	Single Filers	Married Joint Filers
10%	\$0 to \$9,075	\$0 to \$18,150
15%	\$9,076 to \$36,900	\$18,151 to \$73,800
25%	\$36,901 to \$89,350	\$73,801 to \$148,850
28%	\$89,351 to \$186,350	\$148,851 to \$226,850
33%	\$186,351 to \$405,100	\$226,851 to \$405,100
35%	\$405,101 to 406,750	\$405,101 to 457,600
39.6%	\$406,751+	\$457,601+

Source: Internal Revenue Service.

In addition, sole proprietorships and partnerships pay the self-employment (SE) tax. SE taxes are levied on self-employment income in order to fund both Social Security and Medicare and are ultimately equivalent to what wage earners pay in payroll taxes.¹ The SE payroll tax is a combined 15.3 percent on the first \$117,000, 2.9 percent on the next \$83,000, and 3.8 percent on any income above \$200,000 (\$250,000 for joint filers) (Table 3).

Table 3. Payroll and Self-Employment Taxes for a Single Filer, 2014

Taxable Earnings	Social Security	Medicare	Total
\$0–\$117,000	12.40%	2.9%	15.3%
\$117,000–\$200,000	0%	2.9%	2.9%
\$200,000 and over	0%	3.8%	3.8%

Source: Social Security Administration.

Owners of sole proprietorships and partnerships are subject to the SE payroll tax on most of their net business income.² S corporation owners are subject to SE payroll taxes on the portion of their net income paid out in wages. Specifically, an owner of an S corporation can designate his income as either a profit distribution or wages. The income designated as wages is subject to the SE tax while the non-wage income is not.³

S corporation income earned by a passive shareholder—an S corporation owner that does not actively participate in the day-to-day activities of the business but still receives income⁴—is not subject to the SE payroll tax. However, a passive shareholder is liable for the 3.8

1 Half of a worker's payroll taxes are paid by their employer.

2 Rental real estate income is exempt from the self-employment tax.

3 The IRS sets a limit on how much income an owner can designate as a non-wage distribution to prevent abuse.

4 The IRS sets guidelines on what they consider active or passive participation. If shareholders do not satisfy the "material participation" guidelines, the income received from the business is deemed passive and subject to the Net Investment Income Tax. See Michael Kosnitzky & Michael Grisolia, *Net Investment Income Tax Regulations Affecting S Corporations*, http://www.bsflp.com/news/in_the_news/001548/_res/id=sa_File1/.

percent Net Investment Income Tax that was passed as part of the Affordable Care Act.⁵ This tax applies to investment income when a taxpayer's modified AGI exceeds \$200,000 (\$250,000 for joint filers).

Pass-through business income can also be subject to the Alternative Minimum Tax (AMT), which increases the effective tax rate paid by business owners.⁶

In addition, pass-through businesses pay state and local income taxes, which vary from zero percent in states without personal income taxes to 13.3 percent, the top marginal income tax rate in California.⁷

Combined, the top marginal income tax rates faced by pass-through businesses can exceed 50 percent in some cases. For example, the top marginal tax rate faced by sole proprietors in California tops 51.9 percent (see Table 4). The top marginal income tax rate for active shareholders of S corporations is slightly lower, since they do not pay the payroll tax on non-wage, business income (California's top rate is 48.8 percent).⁸ Passive S corporation shareholders in California face an effective marginal rate of 52.6 percent.

Table 4. Top Marginal Tax Rate for a Sole Proprietorship in California

Top Marginal Federal Income Tax	39.60%
Top Marginal State Income Tax	13.30%
Self-employment Tax	3.80%
Deduction for State/Local Income Taxes and Self Employment Taxes (Less Pease)	-4.80%
Total	51.90%

Source: Author's calculations.

The average top marginal income tax rate on sole proprietorships and partnerships in the United States is 47.2 percent, and 44.5 and 48.3 percent, respectively, for active and passive shareholders of S corporations.⁹

5 Regulations require equal distribution among all S corporation shareholders, active or passive. S corporations must distribute enough money to all shareholders, including active shareholders, to cover the 3.8 percent Net Investment Tax, even though active shareholders are not actually required to pay the tax. Although not strictly a tax on S corporations, this limits the amount of money available for reinvestment.

6 More than 2 million income tax returns with pass-through business income were subject to the AMT in 2007. U.S. Department of the Treasury, Office of Tax Analysis, Mathew Knittel et al., OTA Technical Paper 4: *Methodology to Identify Small Businesses and Their Owners* (Aug. 2011), <http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-T2011-04-Small-Business-Methodology-Aug-8-2011.pdf>.

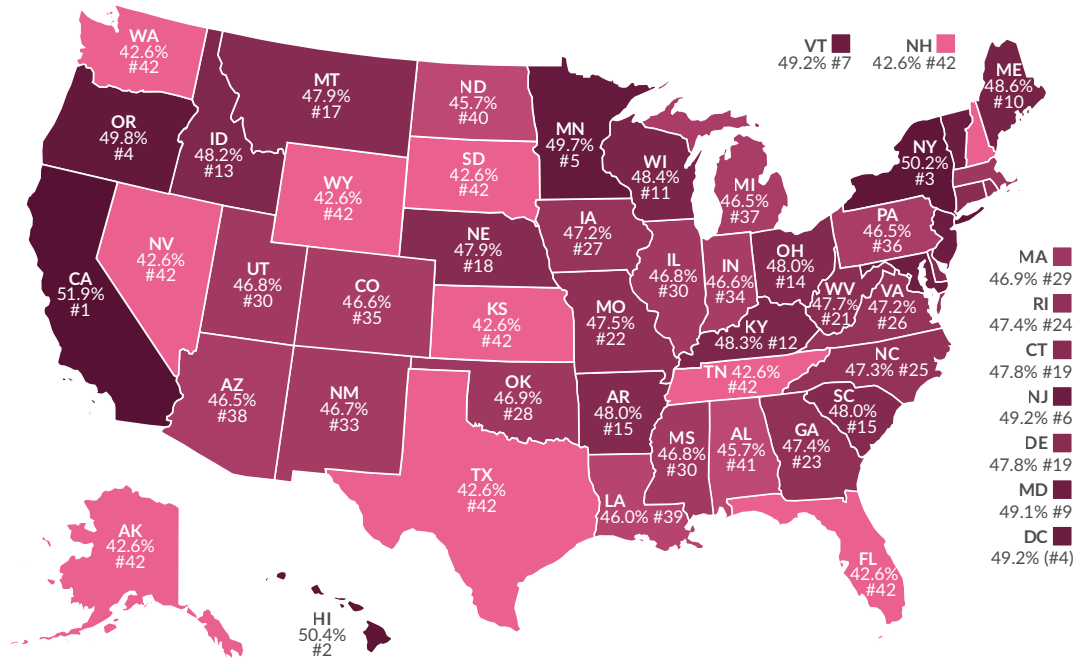
7 Tax Foundation, *State Personal Income Tax Rates and Brackets 2014 Update*, <http://taxfoundation.org/article/state-personal-income-tax-rates-and-brackets-2014-update>.

8 Assuming the last dollar earned by an active shareholder is his non-salary income from his business.

9 Averages are both weighted by the amount of pass-through income in each state. Assumes no effect of Pease in states with no individual income tax. Pease may apply in states with no income tax, in some cases adding 1.118 percent to the marginal rate. Many states also apply gross receipts, margin, and franchise taxes to pass-through business income. These numbers do not account for those.

Figure 1. Pass-through Businesses Face Marginal Tax Rates Over 50 percent in Some States

Combined Federal and State Top Marginal Income Tax Rate on Sole Proprietorships and Partnerships, 2014



Notes: Marginal tax rates include federal, state, and local income taxes, payroll taxes, the deduction for state and local income taxes, and the effect of the Pease limitation on itemized deductions. Published January 20, 2015.

Source: State statutes, state tax forms and instructions; Tax Foundation calculations.

Combined Federal, State, and Local Top Marginal Income Tax Rate on Sole Proprietorships and Partnerships



Tax Differential with Traditional C Corporations

Due to the different tax treatment of pass-through businesses and C corporations, the two business forms face a tax burden differential (see Table 5). C corporations are first taxed at the entity level at the 39.1 percent combined federal and average state tax rate.¹⁰ Then, when those profits are realized by the owners (shareholders) as either dividends or capital gains, the owners pay taxes on that income again. The double-taxation of corporate income creates a disparity between the total tax burden on the income of pass-through businesses and C corporations.

Pass-through businesses facing the top marginal tax rate (combined with the average state rate) face an average rate of 47.2 percent compared to an average total tax rate of 56.5 percent on C corporate income realized at the shareholder level.

¹⁰ Assuming equity-financed investment.

Table 5. Total Tax Burden on Business Income, C Corporation vs. Pass-through Business

	Traditional C corporation	Pass-through business
Entity-Level Tax	39.1%	0.0%
Individual-Level Tax	28.6%	47.2%
Total Tax Rate	56.5%	47.2%

Note: Assumes C corporation distributes dividends. Pass-through business is a partnership.
Source: Author's calculations.

Although traditional C corporations pay a higher overall tax rate on their income, there are specific advantages to the C corporate form that make it worthwhile for some businesses, specifically the ease of raising money, less restrictive shareholder rules (compared to an S corporation), deferral of domestic taxation on foreign income, and the ability to retain earnings without triggering shareholder taxation.¹¹

The Number of Pass-through Businesses Filing Tax Returns Has Greatly Increased Over the Past Thirty Years

The number of pass-through businesses in the United States has increased considerably since the Tax Reform Act of 1986, which substantially lowered individual income tax rates.¹²

Between 1980 and 2011, the number of pass-through business tax returns has increased by 175 percent from roughly 10.9 million returns to about 30 million returns (Figure 2).¹³ The number of sole proprietorships increased from 8.9 million in 1980 to 23.4 million in 2011. The number of partnership businesses grew from 1.3 million returns to 3.2 million returns.

S corporations experienced the fastest growth during this period. From 1980 to 2011, the number of S corporations filing tax returns grew from approximately 545,000 returns to over 4.15 million; an increase of 660 percent, more than three times the rate of growth experienced by pass-through businesses overall.

The number of C corporations filing tax returns during this period steadily declined from 2.2 million returns in 1980 to 1.6 million returns in 2011.

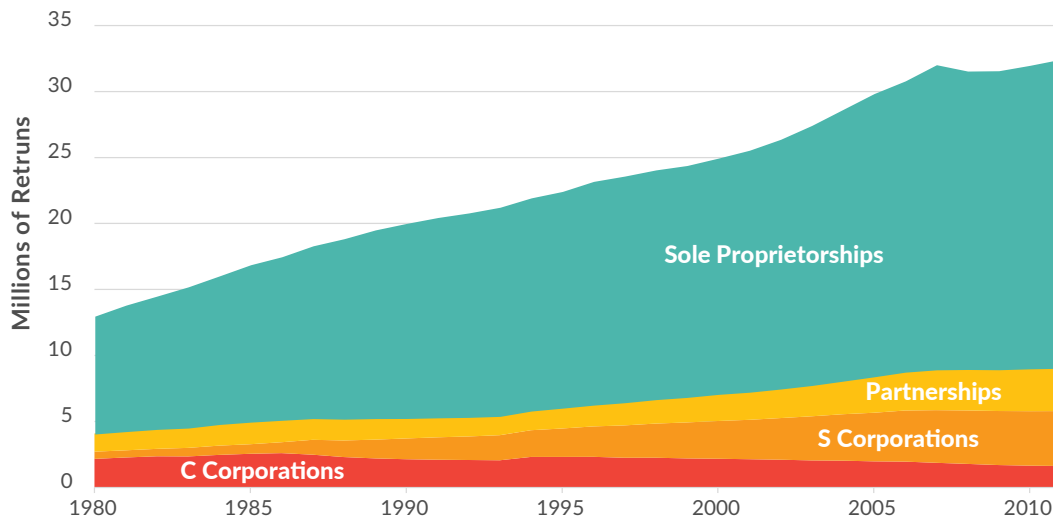
11 Nearly 40 percent of corporate equities are held by tax-exempt organizations and individuals (college endowments, pension funds, and tax preferred retirement accounts). The corporate income passed to these taxpayers is exempt from the second layer of tax. See Congressional Budget Office, *Taxing Capital Income: Effective Marginal Tax Rates Under 2014 Law and Selected Policy Options* (Dec. 2014), http://www.cbo.gov/sites/default/files/cbofiles/attachments/49817-Taxing_Capital_Income_0.pdf.

12 The top marginal individual income tax rates were reduced from 50 percent in 1986 to 28 percent in 1988. This is compared to the corporate income tax rate that was lowered from 46 percent in 1986 to 34 percent in 1988. See Tax Foundation, *U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)*, <http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets>; Tax Foundation, *U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)*, <http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets>.

13 Internal Revenue Service, *SOI Tax Stats – Integrated Business Data, 1980–2008*, <http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data>; Internal Revenue Service, *Business Tax Statistics, 2009–2011*, <http://www.irs.gov/uac/Tax-Stats-2>. IRS data double counts some businesses due to the fact that some private partnerships can be owned by one or more other business entities.

Figure 2. The Number of Pass-through Businesses has Nearly Tripled Since 1980

Number of Business Tax Returns by Business Form, 1980–2011

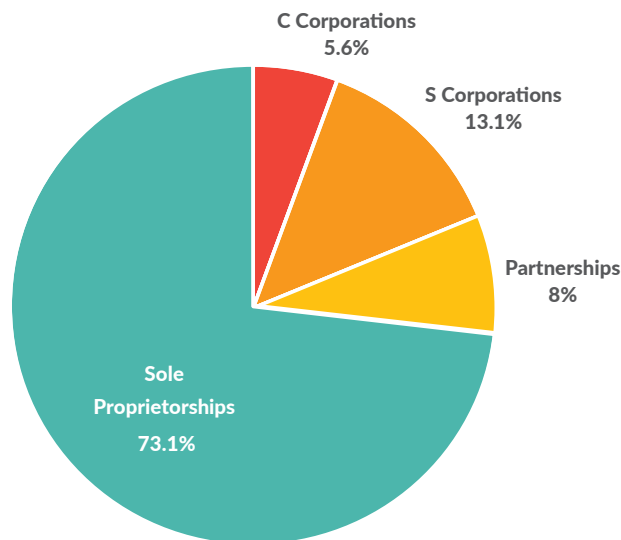


Source: IRS.

Pass-through Businesses Are the Most Common Business Form in the United States

Pass-through businesses are the most common business form in the United States. Of the 27.7 million firms in 2011,¹⁴ about 94 percent of them were pass-through businesses according to the Census Bureau (Figure 3).¹⁵

Figure 3. Sole Proprietorships Are a Majority of All Businesses



Source: Census Bureau.

¹⁴ The number of firms differs from the number of returns. Specifically, an individual firm may own several different businesses that separately file tax returns.

¹⁵ Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Nonemployer Statistics*, <http://www.census.gov/econ/nonemployer/>. 2011 is the most up-to-date year for all data sources.

Sole proprietorships comprise the majority of all business forms. According to Census data, 73.1 percent of all businesses were sole proprietorships (20.3 million firms). 13.1 percent of all businesses were S corporations (3.65 million firms), and about 8 percent were partnerships (2.2 million firms).

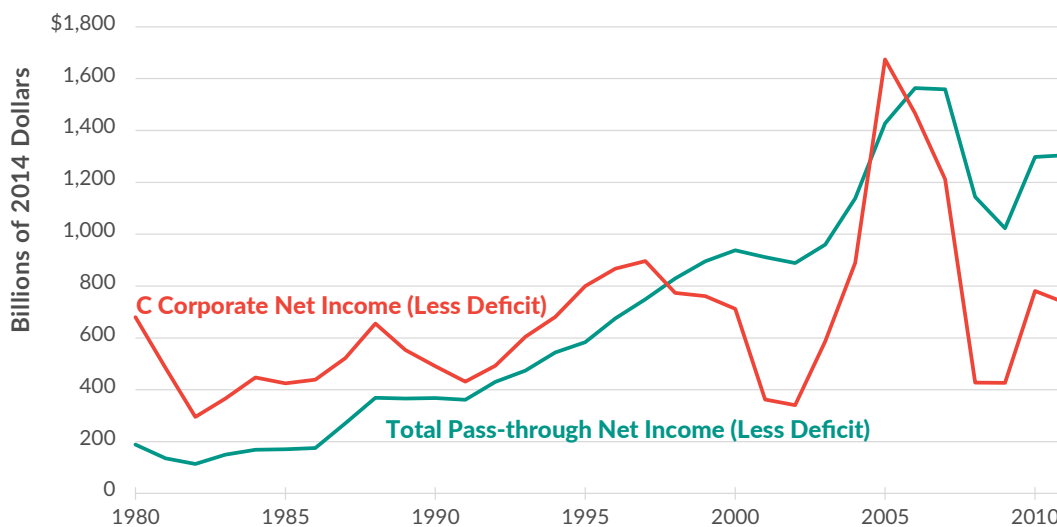
C corporations make up the remaining 5.6 percent of businesses in the United States (1.5 million firms).

Pass-through Businesses Now Earn More Net Income Than Traditional C Corporations

As the number of pass-through businesses increased, they began to generate more net business income as a group than traditional C corporations. The combined net income of sole proprietorships, partnerships, and S corporations in 1980 was \$188 billion compared to total C corporate net income of \$697 billion (Figure 4).¹⁶ By 1998, net pass-through income had grown by 340 percent to \$829 billion, overtaking C corporate income—\$773 billion in 1998—for the first time.

Figure 4. Pass-through Businesses Now Earn More Net Income Than Traditional C Corporations

Net Business Income, C Corporations vs. Pass-through Businesses, 1980–2011



Source: IRS.

Pass-through business income has been persistently higher than corporate income since 1998, with the exception of 2005, when corporate net income peaked at \$1.6 trillion. The most recent data shows that pass-through businesses earned \$1.3 trillion in net income, or 63.9 percent of total business net income in 2011.

¹⁶ Internal Revenue Service, *SOI Tax Stats – Integrated Business Data, 1980–2008*, <http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data>; Internal Revenue Service, *Business Tax Statistics, 2009–2011*, <http://www.irs.gov/uac/Tax-Stats-2>.

Most of the Private Sector Workforce Works at, or Is Self-Employed as, a Pass-through Business

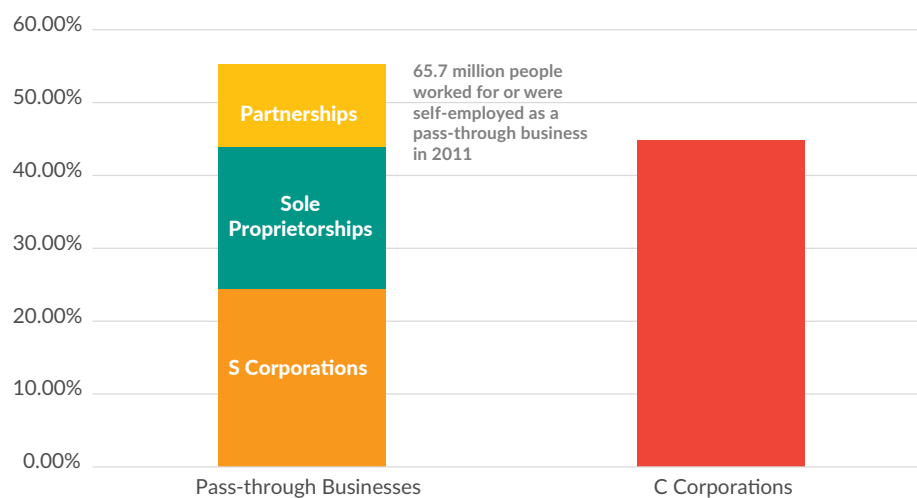
Not only do pass-through businesses earn more net income than traditional C corporations, they also account for more employment.

According to 2011 Census data, pass-through businesses account for 55.2 percent of all private sector employment.¹⁷ This represents 65.7 million workers. In contrast, traditional C corporations comprise 44.7 percent of the private sector workforce, or 53.2 million workers.

S corporations account for the most employment of all pass-through business types. In 2011, S corporations employed 24.4 percent of the private sector workforce, or 29 million workers. Sole Proprietorships comprised 19.5 percent of the private sector workforce. Partnerships accounted for the lowest amount of employment with only 11.3 percent of the private sector workforce.

Figure 5. Pass-through Businesses Employ More Than Half of the Private Sector Workforce

Share of Private Sector Workforce by Business Type, 2011



Source: Census Bureau.

Pass-Through Businesses Are Generally Smaller Than C Corporations, but Pass-Through Businesses Are Not Always Small Businesses

A major reason why C corporations account for a significant amount of employment but so few firms is that they are significantly larger than pass-through businesses on average. Figure 6, below, compares the distribution of pass-through and corporate employment by the size of firm.

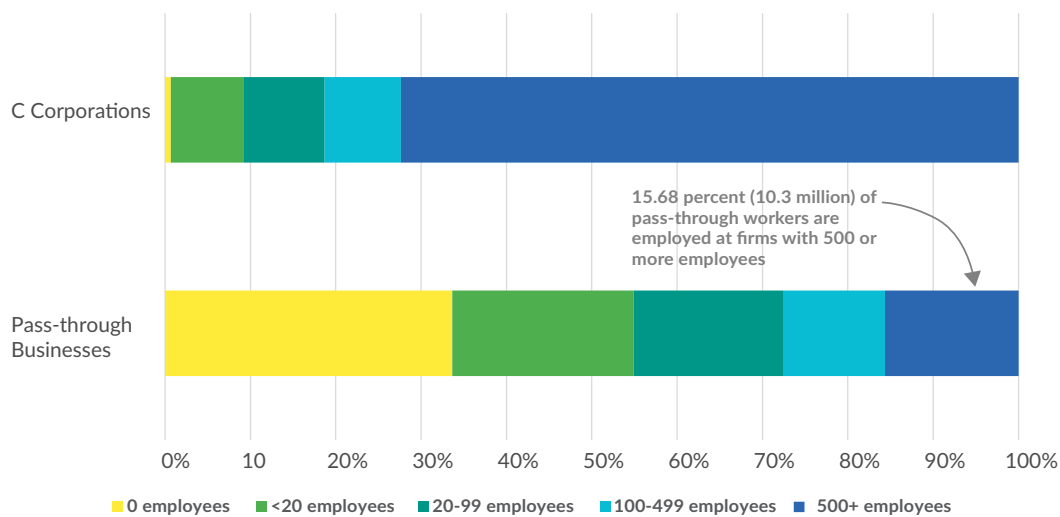
¹⁷ Numbers include self-employed individuals in order to get a complete picture of employment by business form. Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

Employment at C corporations is heavily concentrated in large firms. In 2011, 72.3 percent (38 million) of C corporate workers were employed at large firms with 500 or more employees with an additional 8.9 percent (4.7 million) working at firms with between 100 and 500 employees.¹⁸ The remaining 18.7 percent (9.9 million) of corporate employment was at firms with fewer than 100 employees.

Pass-through business employment is more heavily distributed among smaller firms. However, it would be a mistake to completely conflate pass-through businesses with small businesses. While most pass-through employment is either self-employment (33.6 percent) or at small firms with between 1 and 100 employees (38.7 percent), a significant number of employees work at large pass-through businesses. According to 2011 Census data, a combined 27.5 percent (18.1 million) of pass-through employment was at firms with more than 100 employees, and 15.9 percent (10.3 million) of pass-through employees work at large firms with 500 or more employees.

Figure 6. Not All Pass-through Businesses Are Small Businesses

Distribution of Pass-through and Corporate Employment by Firm Size, 2011



Source: Census Bureau.

Pass-through Businesses Account for Most of the Private Sector Workforce in 48 States

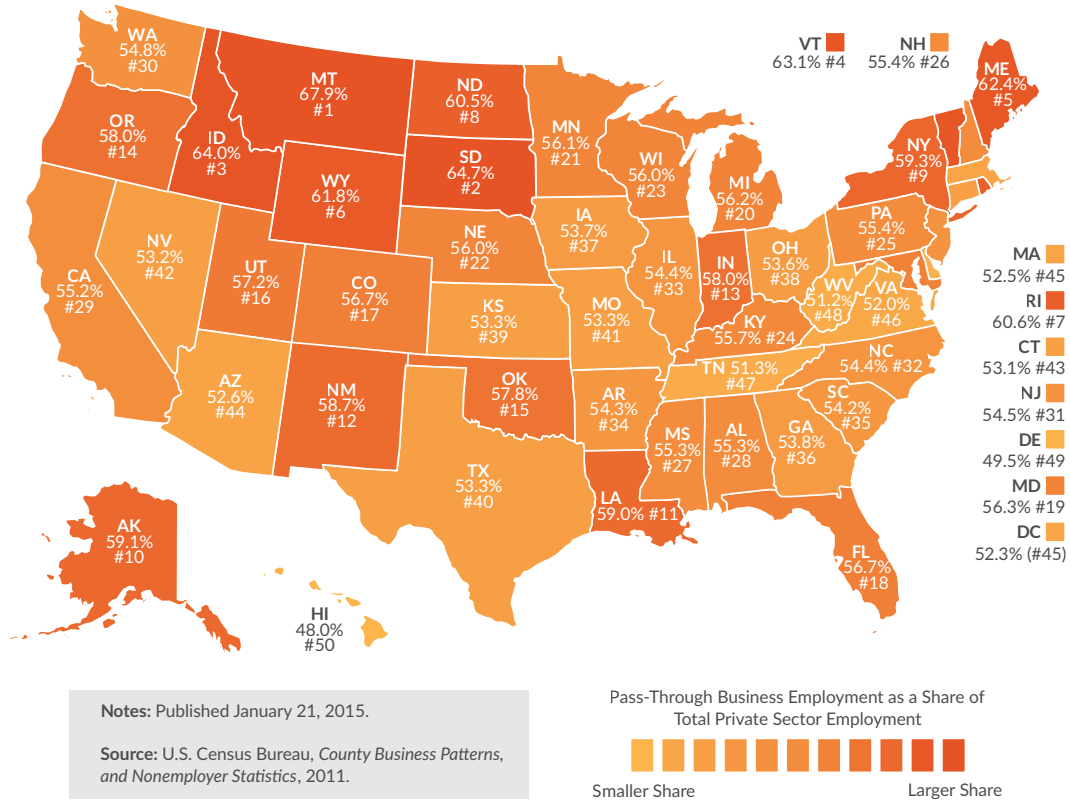
The prevalence of pass-through employment varies among U.S. states. According to Census Bureau data, pass-through businesses accounted more than 60 percent of business employment in eight states: Idaho (64 percent), Maine (62.4 percent), Montana (67.9 percent), North Dakota (60.5 percent), Rhode Island (60.6 percent), South Dakota (64.7

¹⁸ Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

percent), Vermont (63.1 percent), and Wyoming (61.8 percent).¹⁹ In contrast, Delaware (49.5 percent) and Hawaii (48 percent) had pass-through employment as a share of total private sector employment of less than 50 percent.²⁰

Figure 7. Pass-through Businesses Account for Most Private Sector Employment in Nearly all States

Pass-through Business Employment as a Share of Total Private Sector Employment, 2011



Pass-Through Businesses Accounted for Nearly 40 Percent of Private Sector Payroll

Pass-through businesses also account for a significant amount of private sector payroll. Of the \$4.48 trillion of salaries and wages paid in 2011, pass-through businesses accounted for approximately \$1.65 trillion, or 37 percent (Figure 8).²¹ S corporations accounted for most pass-through business payroll with a total of \$1 trillion. Partnerships paid \$505 billion and sole proprietorships paid \$98 billion.²²

19 Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

20 See Appendix for full employment data table.

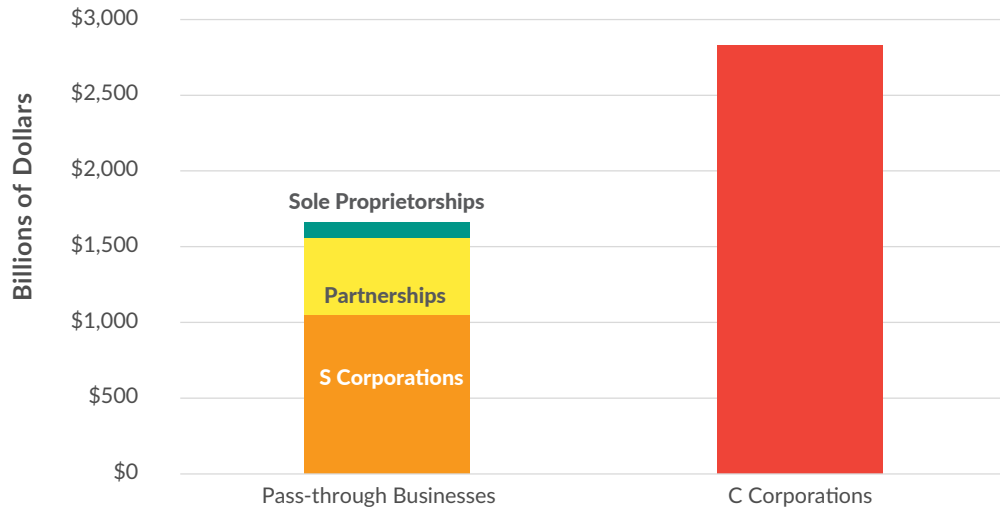
21 Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

22 These numbers do not account for self-employment income, which is disproportionately earned by pass-through businesses, especially sole proprietorships. Unincorporated self-employed individuals reported approximately \$600 billion in gross receipts in 2011. However, gross receipts cannot be directly compared to payroll due to the omission of business expenses. Wages would more accurately be compared to gross receipts minus costs.

However, given their larger size, C corporations accounted for most of the private sector payroll in the United States. In 2011, 63 percent of private sector payroll was paid by C corporations, or \$2.8 trillion.²³

Figure 8. Pass-through Businesses Paid \$1.6 Trillion in Wages and Salaries in 2011

Total Payroll by Business Form, 2011



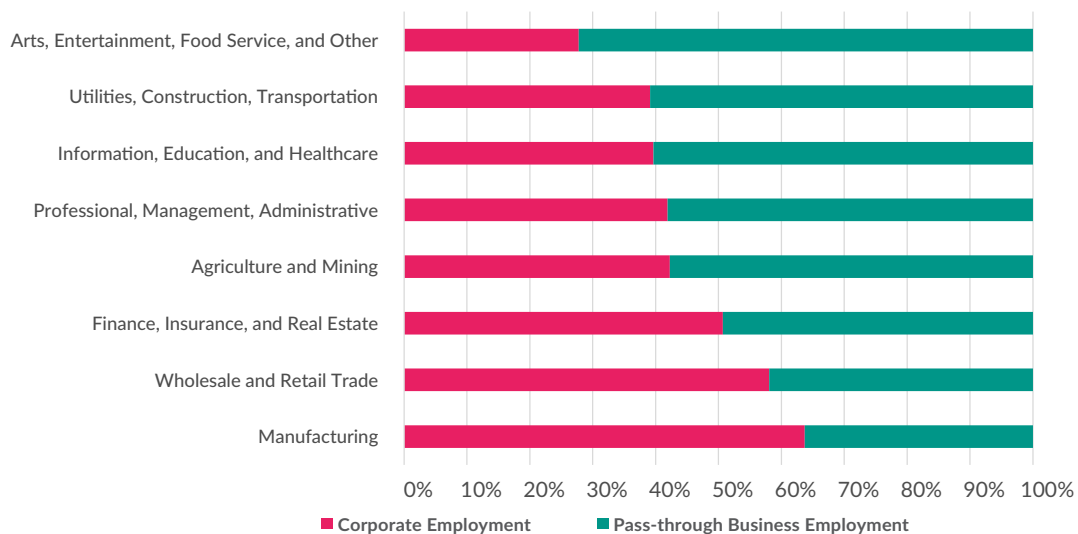
Source: Census Bureau.

Pass-through Businesses Employ the Majority of Workers in Service Sector Industries

Pass-through businesses employ workers in every industry. However, service sector industries have larger shares of pass-through employment than corporate employment. In contrast, manufacturing and trade industries are dominated by C corporate employment.

Figure 9. Pass-through Business Employment Dominates Service Industries

Share of Corporate and Pass-through Employment by Industry, 2011



Source: Census Bureau.

23 See Appendix for full data table with payroll by state and business form for 2011.

Figure 9 shows the share of corporate versus pass-through employment by industry. According to Census data, pass-through business employment accounts for most employment in most industries. Pass-through employment accounts for 60 percent or more employment in the Arts, Entertainment, and Food Service (72.1 percent); Utilities, Construction, and Transportation (60.8 percent); and Information, Education, and Healthcare (60.3 percent) industries.²⁴

C corporations accounted for a majority of employment in only three major industries: manufacturing (63.7 percent); wholesale and retail trade (58 percent); and Finance, Insurance, and Real Estate (50.6 percent).

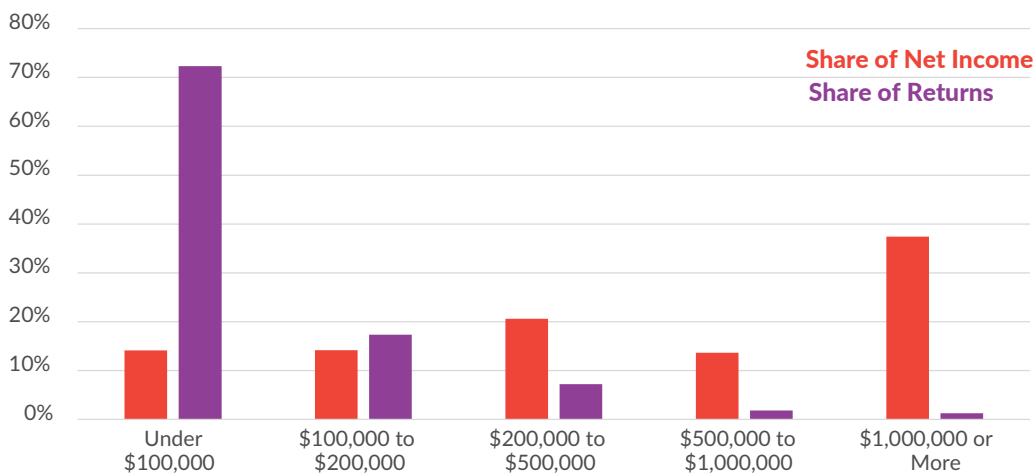
Although C corporations accounted for more employment in these industries, there are consistently more pass-through businesses (firms) in all industries. For example, most employment in manufacturing is at C corporations, but the vast majority of manufacturing firms are pass-through businesses.²⁵ (See Appendix for complete industry numbers.)

High Income Individuals Report Most Pass-through Business Income

Since pass-through business income is taxed at the individual level, the distribution of pass-through income across individuals is important in understanding the effect of individual marginal tax rates.

Figure 10. High Income Taxpayers Report Most Pass-through Business Income

Distribution of Total Pass-through Income



Source: IRS.

²⁴ Census Bureau, *County Business Patterns*, <http://www.census.gov/econ/cbp/>; Census Bureau, *Statistics of U.S. Businesses*, <http://www.census.gov/econ/susb/>; Census Bureau, *Nonemployer Statistics 2011*, <http://www.census.gov/econ/nonemployer/>.

²⁵ Robert Carroll & Gerald Prante, *The Flow-Through Business Sector and Tax Reform: The economic footprint of the flow-through sector and the potential impact of tax reform* (Apr. 2011), <http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf>.

If most pass-through business income were earned by low to moderate income individuals, pass-through business income would face relatively low marginal rates. Conversely, if most business income is earned by high-income individuals, pass-through business income would be taxed at potentially high marginal rates.

According to IRS data, 72 percent of returns with business income reported between \$1 and \$100,000 in business income.²⁶ However, these returns only accounted for 14 percent of total business income.²⁷

The largest concentration of pass-through business income was reported on the 1.3 percent of returns that earned \$1 million in net business income or more. This group of taxpayers earned 37 percent of total pass-through business income.

Combined with the 1.8 percent of tax returns with business income between \$500,000 and \$1 million, 51 percent of business income was earned by the few taxpayers (3.1 percent of returns) with net business income of \$500,000 or more.

This means that 51 percent of pass-through business income in 2012 was potentially subject to the federal top marginal tax rate on individual income of 39.6 percent.

Conclusion

In the last thirty years, the number of pass-through businesses has greatly increased while the number of C corporations has declined. As a result, pass-through businesses now account for 94 percent of all businesses, earn more than 64 percent of total business net income, and employ more than half of the private sector workforce in the United States. In addition, they pay more than \$1.6 trillion in wages and salaries and operate in every U.S. industry.

One of the main goals of fundamental tax reform is to make U.S. businesses more competitive and to increase economic growth. This requires a reduction in taxes on businesses and investment. Most attention is given to traditional C corporations because they face high tax burdens by international standards and account for a large amount of economic activity. As a result, less attention has been given to pass-through businesses. Since pass-through businesses now account for more than half of the business income and employment in the United States, any business tax reform needs to address the individual income tax code as well as the corporate income tax code.

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Editor, Donnie Johnson
Designer, Dan Carvajal

Tax Foundation
National Press Building
1325 G Street, NW,
Suite 950
Washington, DC
20005

202.464.6200

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²⁶ Internal Revenue Service, *SOI Tax Stats – Individual Statistical Tables by Size of Adjusted Gross Income*, Table 1.4, <http://www.irs.gov/uac/SOI-Tax-Stats---Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income>. Business income includes: business and professional income (Schedule C, 1040 Line 12), Rents, Royalties, S Corporation and Partnerships income (Schedule E), and Farm Income (Schedule F).

²⁷ It is important to note that individuals can report business income from incidental business activity. For example, an individual can earn rental income from a vacation home.

Appendix

Appendix Table 1. Combined Top Marginal Tax Rate on Pass-through Businesses by State, 2014

State	Top Marginal Income Tax Rate (Sole Proprietorships/Partnerships)	Top Marginal Income Tax Rate (S Corporations)	
		Active Shareholders	Passive Shareholders
Alabama	45.65%	42.67%	46.47%
Alaska	42.58%	39.60%	43.40%
Arizona	46.51%	43.53%	47.33%
Arkansas	48.00%	45.02%	48.82%
California	51.86%	48.88%	52.68%
Colorado	46.56%	43.58%	47.38%
Connecticut	47.81%	44.83%	48.63%
Delaware	47.81%	44.83%	48.63%
Florida	42.58%	39.60%	43.40%
Georgia	47.39%	44.41%	48.21%
Hawaii	50.41%	47.43%	51.23%
Idaho	48.24%	45.26%	49.06%
Illinois	46.79%	43.81%	47.61%
Indiana	46.61%	43.63%	47.43%
Iowa	47.22%	44.25%	48.05%
Kansas	42.58%	39.60%	43.40%
Kentucky	48.30%	45.32%	49.12%
Louisiana	45.96%	42.98%	46.78%
Maine	48.57%	45.59%	49.39%
Maryland	49.05%	46.07%	49.87%
Massachusetts	46.91%	43.93%	47.73%
Michigan	46.52%	43.54%	47.34%
Minnesota	49.72%	46.74%	50.54%
Mississippi	46.79%	43.81%	47.61%
Missouri	47.51%	44.53%	48.33%
Montana	47.93%	44.96%	48.76%
Nebraska	47.90%	44.92%	48.72%
Nevada	42.58%	39.60%	43.40%
New Hampshire	42.58%	39.60%	43.40%
New Jersey	49.18%	46.21%	50.01%
New Mexico	46.73%	43.75%	47.55%
New York	50.24%	47.26%	51.06%
North Carolina	47.27%	44.29%	48.09%
North Dakota	45.71%	42.73%	46.53%
Ohio	48.01%	45.03%	48.83%
Oklahoma	46.94%	43.96%	47.76%
Oregon	49.81%	46.83%	50.63%
Pennsylvania	46.53%	43.55%	47.35%
Rhode Island	47.38%	44.41%	48.21%
South Carolina	48.00%	45.02%	48.82%
South Dakota	42.58%	39.60%	43.40%
Tennessee	42.58%	44.41%	48.21%
Texas	42.58%	39.60%	43.40%
Utah	46.79%	43.81%	47.61%
Vermont	49.17%	46.19%	49.99%
Virginia	47.24%	44.26%	48.06%
Washington	42.58%	39.60%	43.40%
West Virginia	47.69%	44.71%	48.51%
Wisconsin	48.39%	45.41%	49.21%
Wyoming	42.58%	39.60%	43.40%
District of Columbia	49.17%	46.19%	49.99%
U.S. Average	47.25%	44.51%	48.31%

Note: Many states also apply gross receipts, margin, and franchise taxes to pass-through business income. These numbers do not account for those.

Source: Author's calculations.

Appendix Table 2. Employment by Business Form and State, 2011

State	C Corporations		Pass-through Total		Sole Proprietorship		Partnership		S Corporations	
	Share	Employment	Share	Employment	Share	Employment	Share	Employment	Share	Employment
Alabama	44.66%	759,390	55.34%	941,143	19.86%	337,810	10.38%	176,477	25.10%	426,856
Alaska	40.87%	109,453	59.13%	158,359	22.64%	60,631	11.60%	31,054	24.90%	66,674
Arizona	47.42%	1,082,867	52.58%	1,200,610	17.43%	397,950	12.50%	285,528	22.65%	517,132
Arkansas	45.68%	470,789	54.32%	559,763	19.41%	200,025	10.43%	107,464	24.48%	252,274
California	44.79%	6,281,899	55.21%	7,743,121	22.55%	3,162,609	9.67%	1,356,736	22.99%	3,223,776
Colorado	43.28%	940,781	56.72%	1,233,139	18.54%	402,999	13.04%	283,389	25.15%	546,751
Connecticut	46.90%	670,857	53.10%	759,461	20.03%	286,557	14.79%	211,596	18.27%	261,308
Delaware	50.50%	183,955	49.50%	180,326	13.57%	49,425	13.63%	49,656	22.30%	81,245
District of Columbia	47.72%	167,067	52.28%	183,012	15.44%	54,037	21.26%	74,435	15.58%	54,540
Florida	43.30%	3,347,252	56.70%	4,382,664	19.28%	1,490,678	9.57%	739,885	27.84%	2,152,101
Georgia	46.21%	1,728,269	53.79%	2,011,755	20.61%	770,791	9.64%	360,372	23.55%	880,592
Hawaii	51.96%	262,206	48.04%	242,420	20.58%	103,853	10.32%	52,053	17.14%	86,514
Idaho	35.98%	192,506	64.02%	342,513	21.29%	113,916	15.06%	80,578	27.67%	148,019
Illinois	45.65%	2,381,740	54.35%	2,836,017	17.50%	912,902	9.85%	513,968	27.01%	1,409,147
Indiana	41.98%	1,036,757	58.02%	1,433,031	16.49%	407,276	11.75%	290,192	29.78%	735,563
Iowa	46.27%	570,868	53.73%	662,857	17.63%	217,458	8.79%	108,486	27.31%	336,913
Kansas	46.70%	526,274	53.30%	600,592	18.27%	205,836	10.72%	120,835	24.31%	273,921
Kentucky	44.34%	677,683	55.66%	850,549	19.90%	304,105	11.74%	179,351	24.02%	367,093
Louisiana	41.03%	712,283	58.97%	1,023,924	20.02%	347,506	15.05%	261,321	23.91%	415,097
Maine	37.64%	182,221	62.36%	301,958	24.41%	118,201	8.29%	40,159	29.66%	143,598
Maryland	43.75%	952,896	56.25%	1,225,339	20.13%	438,505	10.55%	229,728	25.58%	557,106
Massachusetts	47.52%	1,322,241	52.48%	1,460,544	18.21%	506,686	9.62%	267,801	24.65%	686,057
Michigan	43.80%	1,553,073	56.20%	1,992,942	19.41%	688,336	11.44%	405,675	25.35%	898,931
Minnesota	43.94%	1,012,541	56.06%	1,291,745	17.43%	401,737	8.43%	194,226	30.20%	695,782
Mississippi	44.65%	425,946	55.35%	528,010	22.49%	214,554	11.23%	107,121	21.63%	206,335
Missouri	46.72%	1,076,499	53.28%	1,227,605	18.39%	423,710	10.66%	245,567	24.23%	558,328
Montana	32.10%	113,952	67.90%	241,049	23.97%	85,091	11.13%	39,516	32.80%	116,442
Nebraska	44.02%	350,531	55.98%	445,817	16.58%	132,034	8.72%	69,434	30.68%	244,349
Nevada	46.82%	530,211	53.18%	602,201	17.00%	192,474	15.32%	173,438	20.87%	236,289
New Hampshire	44.65%	250,754	55.35%	310,874	20.67%	116,064	9.60%	53,901	25.09%	140,909
New Jersey	45.46%	1,617,960	54.54%	1,941,400	17.12%	609,281	13.66%	486,253	23.76%	845,866
New Mexico	41.31%	262,688	58.69%	373,147	20.85%	132,589	12.97%	82,499	24.86%	158,059
New York	40.69%	2,985,817	59.31%	4,351,881	21.13%	1,550,289	12.49%	916,635	25.69%	1,884,957
North Carolina	45.56%	1,576,409	54.44%	1,883,894	19.20%	664,216	9.47%	327,524	25.78%	892,154
North Dakota	39.54%	111,283	60.46%	170,176	18.77%	52,831	10.37%	29,201	31.32%	88,144
Ohio	46.43%	2,071,166	53.57%	2,389,484	17.68%	788,483	11.40%	508,487	24.49%	1,092,514
Oklahoma	42.23%	573,296	57.77%	784,340	20.33%	276,021	13.08%	177,594	24.36%	330,725
Oregon	42.03%	577,733	57.97%	796,751	19.97%	274,531	11.04%	151,715	26.96%	370,505
Pennsylvania	44.64%	2,150,826	55.36%	2,667,428	18.03%	868,870	10.54%	507,738	26.79%	1,290,820
Rhode Island	39.39%	152,988	60.61%	235,359	19.30%	74,945	8.40%	32,629	32.90%	127,785
South Carolina	45.77%	751,398	54.23%	890,332	19.01%	312,102	10.95%	179,753	24.27%	398,477
South Dakota	35.27%	111,142	64.73%	203,998	20.85%	65,698	11.28%	35,561	32.60%	102,739
Tennessee	48.72%	1,193,808	51.28%	1,256,432	22.21%	544,306	14.90%	364,991	14.17%	347,135
Texas	46.72%	4,715,695	53.28%	5,378,460	21.02%	2,121,668	14.54%	1,468,145	17.72%	1,788,647
Utah	42.84%	472,883	57.16%	630,968	15.39%	169,915	14.84%	163,839	26.93%	297,214
Vermont	36.88%	96,160	63.12%	164,610	26.69%	69,589	9.45%	24,653	26.98%	70,368
Virginia	48.01%	1,521,565	51.99%	1,647,972	16.81%	532,800	10.01%	317,146	25.18%	798,026
Washington	45.23%	1,087,939	54.77%	1,317,293	18.45%	443,831	10.73%	258,114	25.58%	615,348
West Virginia	48.80%	270,479	51.20%	283,815	19.43%	107,701	11.77%	65,268	20.00%	110,846
Wisconsin	44.03%	1,002,392	55.97%	1,274,178	16.53%	376,296	9.90%	225,355	29.54%	672,527
Wyoming	38.17%	86,542	61.83%	140,161	20.13%	45,631	13.22%	29,965	28.48%	64,565

Source: Author's calculations based on U.S. Census data.

Appendix Table 3. Payroll by Business Form and State, 2011

State	C Corporate Payroll		Pass-Through Payroll		Sole Proprietorship Payroll		Partnership Payroll		S Corporation Payroll	
	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount
Alabama	60.5%	\$32,007,619	39.5%	\$20,921,116	2.3%	\$1,242,116	9.35%	\$4,948,624	27.8%	\$14,730,376
Alaska	58.9%	\$6,837,634	41.1%	\$4,777,962	3.9%	\$450,529	10.87%	\$1,263,055	26.4%	\$3,064,378
Arizona	66.4%	\$50,723,125	33.6%	\$25,705,549	1.5%	\$1,138,622	10.18%	\$7,778,764	22.0%	\$16,788,163
Arkansas	65.0%	\$19,880,118	35.0%	\$10,727,277	1.8%	\$548,160	9.68%	\$2,962,057	23.6%	\$7,217,060
California	66.3%	\$391,528,884	33.7%	\$199,022,094	2.5%	\$14,631,666	9.64%	\$56,916,574	21.6%	\$127,473,854
Colorado	62.2%	\$51,740,233	37.8%	\$31,422,572	1.5%	\$1,285,006	11.89%	\$9,889,960	24.3%	\$20,247,606
Connecticut	65.0%	\$45,463,512	35.0%	\$24,480,045	2.6%	\$1,806,889	15.18%	\$10,618,564	17.2%	\$12,054,592
Delaware	63.1%	\$9,733,653	36.9%	\$5,699,143	1.4%	\$221,388	17.36%	\$2,679,297	18.1%	\$2,798,458
District of Columbia	56.5%	\$12,464,549	43.5%	\$9,595,380	2.9%	\$630,936	27.74%	\$6,119,752	12.9%	\$2,844,692
Florida	59.9%	\$142,247,165	40.1%	\$95,084,198	1.3%	\$3,105,904	10.41%	\$24,716,547	28.3%	\$67,261,747
Georgia	66.1%	\$83,965,206	33.9%	\$43,133,496	1.6%	\$1,976,450	9.93%	\$12,619,545	22.5%	\$28,537,501
Hawaii	68.3%	\$10,349,394	31.7%	\$4,807,095	3.6%	\$549,641	10.35%	\$1,568,729	17.7%	\$2,688,725
Idaho	52.5%	\$7,778,024	47.5%	\$7,026,080	2.2%	\$320,483	15.97%	\$2,364,049	29.3%	\$4,341,548
Illinois	62.0%	\$132,851,641	38.0%	\$81,256,813	2.1%	\$4,574,599	11.38%	\$24,375,339	24.4%	\$52,306,875
Indiana	57.4%	\$47,204,435	42.6%	\$35,090,766	2.1%	\$1,724,555	11.25%	\$9,255,257	29.3%	\$24,110,954
Iowa	63.3%	\$24,808,579	36.7%	\$14,408,835	2.2%	\$844,610	6.90%	\$2,704,843	27.7%	\$10,859,382
Kansas	65.0%	\$24,718,807	35.0%	\$13,321,261	2.2%	\$828,865	8.77%	\$3,336,798	24.1%	\$9,155,598
Kentucky	61.7%	\$28,913,905	38.3%	\$17,918,397	3.8%	\$1,788,935	10.67%	\$4,994,966	23.8%	\$11,134,496
Louisiana	55.6%	\$32,183,055	44.4%	\$25,695,038	2.3%	\$1,350,352	16.15%	\$9,344,547	25.9%	\$15,000,139
Maine	56.3%	\$7,762,347	43.7%	\$6,035,022	3.2%	\$438,128	7.41%	\$1,021,861	33.2%	\$4,575,033
Maryland	59.9%	\$51,226,319	40.1%	\$34,226,875	2.2%	\$1,913,324	9.98%	\$8,531,057	27.8%	\$23,782,494
Massachusetts	66.7%	\$89,890,293	33.3%	\$44,910,224	1.7%	\$2,327,184	9.78%	\$13,178,838	21.8%	\$29,404,202
Michigan	62.3%	\$78,744,124	37.7%	\$47,663,679	1.9%	\$2,449,317	10.78%	\$13,623,258	25.0%	\$31,591,104
Minnesota	63.8%	\$59,108,837	36.2%	\$33,589,449	1.9%	\$1,764,278	7.62%	\$7,059,076	26.7%	\$24,766,095
Mississippi	62.9%	\$15,818,019	37.1%	\$9,310,039	2.8%	\$698,193	10.93%	\$2,747,398	23.3%	\$5,864,448
Missouri	64.7%	\$50,397,113	35.3%	\$27,542,251	1.9%	\$1,486,279	9.51%	\$7,411,191	23.9%	\$18,644,781
Montana	51.2%	\$4,632,791	48.8%	\$4,423,065	2.9%	\$259,706	9.29%	\$841,740	36.7%	\$3,321,619
Nebraska	58.8%	\$15,008,653	41.2%	\$10,536,723	1.7%	\$443,661	6.90%	\$1,763,625	32.6%	\$8,329,437
Nevada	59.2%	\$21,750,823	40.8%	\$14,967,337	4.1%	\$1,497,066	14.65%	\$5,377,575	22.0%	\$8,092,696
New Hampshire	61.6%	\$12,618,559	38.4%	\$7,856,197	3.0%	\$620,889	7.10%	\$1,453,691	28.2%	\$5,781,617
New Jersey	64.5%	\$106,136,669	35.5%	\$58,534,325	2.0%	\$3,235,618	10.88%	\$17,912,850	22.7%	\$37,385,857
New Mexico	56.4%	\$10,599,304	43.6%	\$8,204,404	2.7%	\$512,359	15.03%	\$2,825,448	25.9%	\$4,866,597
New York	59.9%	\$218,057,598	40.1%	\$146,082,409	2.1%	\$7,636,085	16.49%	\$60,063,617	21.5%	\$78,382,707
North Carolina	65.0%	\$73,648,168	35.0%	\$39,575,743	1.9%	\$2,183,591	8.59%	\$9,723,911	24.4%	\$27,668,241
North Dakota	57.0%	\$5,435,830	43.0%	\$4,099,686	2.3%	\$217,953	7.94%	\$757,496	32.8%	\$3,124,237
Ohio	63.7%	\$99,012,006	36.3%	\$56,340,183	2.1%	\$3,266,377	10.12%	\$15,722,600	24.0%	\$37,351,206
Oklahoma	60.8%	\$26,676,707	39.2%	\$17,185,828	2.4%	\$1,032,740	12.38%	\$5,428,372	24.5%	\$10,724,716
Oregon	63.0%	\$29,763,256	37.0%	\$17,498,294	2.3%	\$1,072,023	8.37%	\$3,955,555	26.4%	\$12,470,716
Pennsylvania	61.1%	\$111,739,161	38.9%	\$71,289,612	2.6%	\$4,823,178	9.53%	\$17,438,586	26.8%	\$49,027,848
Rhode Island	54.1%	\$7,406,493	45.9%	\$6,294,069	4.6%	\$625,134	7.34%	\$1,005,234	34.0%	\$4,663,701
South Carolina	62.2%	\$29,860,505	37.8%	\$18,155,968	2.3%	\$1,107,622	10.60%	\$5,091,516	24.9%	\$11,956,830
South Dakota	49.6%	\$4,249,432	50.4%	\$4,325,195	2.8%	\$243,397	10.20%	\$874,870	37.4%	\$3,206,928
Tennessee	66.6%	\$53,449,846	33.4%	\$26,780,728	3.1%	\$2,481,896	13.86%	\$11,118,643	16.4%	\$13,180,189
Texas	65.5%	\$249,208,105	34.5%	\$131,034,636	2.3%	\$8,837,959	15.18%	\$57,711,580	17.0%	\$64,485,097
Utah	60.7%	\$21,540,940	39.3%	\$13,958,186	1.2%	\$419,387	11.21%	\$3,979,060	26.9%	\$9,559,739
Vermont	56.6%	\$4,248,011	43.4%	\$3,255,347	3.5%	\$265,584	7.24%	\$543,079	32.6%	\$2,446,684
Virginia	63.5%	\$82,006,387	36.5%	\$47,083,789	1.9%	\$2,401,574	9.68%	\$12,501,885	24.9%	\$32,180,330
Washington	65.7%	\$67,815,134	34.3%	\$35,472,191	2.5%	\$2,573,819	8.62%	\$8,906,822	23.2%	\$23,991,550
West Virginia	66.9%	\$11,431,956	33.1%	\$5,666,790	3.4%	\$581,332	10.32%	\$1,763,804	19.4%	\$3,321,654
Wisconsin	60.4%	\$48,179,529	39.6%	\$31,615,544	2.3%	\$1,854,671	7.78%	\$6,204,305	29.5%	\$23,556,568
Wyoming	56.1%	\$4,545,034	43.9%	\$3,559,474	2.3%	\$188,161	10.63%	\$861,799	31.0%	\$2,509,514

Note: Does not include non-employer firms; dollar amounts in thousands.

Source: Author's calculations based on U.S. Census data.

Appendix Table 4. Pass-through Businesses, Employment, and Payroll by Industry

NAICS Classification	NAICS Code	Total Private Sector			C Corporations			Pass-through Businesses		
		Firms	Employment	Payroll	Firms	Employment	Payroll	Firms	Employment	Payroll
Agriculture, forestry, fishing and hunting	11	258188	386229	\$5,186,733	6767	50678	\$1,957,557	251421	335551	\$3,229,176
Mining, quarrying, and oil and gas extraction	21	131247	758959	\$55,142,854	8863	433115	\$39,779,751	122384	325844	\$15,363,103
Utilities	22	20703	580534	\$52,791,916	2159	537163	\$50,520,384	18544	43371	\$2,271,532
Construction	23	3032846	7570862	\$264,873,890	180636	1862122	\$101,836,009	2852210	5708740	\$163,037,881
Manufacturing	31-33	585945	11237036	\$571,217,485	95521	7160805	\$406,976,997	490424	4076231	\$164,240,488
Wholesale trade	42	712192	5955180	\$353,649,072	129530	3223821	\$230,411,033	582662	2731359	\$123,238,039
Retail trade	44-45	2498799	16365278	\$366,560,872	191122	9735727	\$233,317,378	2307677	6629551	\$133,243,494
Transportation and warehousing	48-49	1202842	5115544	\$174,926,243	62017	2794022	\$125,680,588	1140825	2321522	\$49,245,655
Information	51	383354	3340315	\$229,570,366	29305	2323834	\$188,692,027	354049	1016481	\$40,878,339
Finance and insurance	52	940019	6214086	\$472,183,897	63534	4461143	\$376,795,088	876485	1752943	\$95,388,809
Real estate and rental and leasing	53	2604917	4209817	\$82,333,393	132816	823592	\$36,584,148	2472101	3386225	\$45,749,245
Professional, scientific, and technical services	54	3924278	10847469	\$551,274,359	200958	3681456	\$302,677,017	3723320	7166013	\$248,597,342
Management of companies and enterprises	55	25009	2605175	\$278,703,195	12321	2131746	\$240,527,725	12688	473429	\$38,175,470
Administrative and support and waste management and remediation services	56	2301092	11257122	\$321,620,087	79696	4547393	\$176,609,396	2221396	6709729	\$145,010,691
Educational services	61	630490	1405289	\$25,206,522	13364	400570	\$14,262,759	617126	1004719	\$10,943,763
Health care and social assistance	62	2534133	10742519	\$367,325,270	125854	3421261	\$175,269,506	2408279	7321258	\$192,055,764
Arts, entertainment, and recreation	71	1277971	2545644	\$47,681,968	31199	541619	\$16,208,131	1246772	2004025	\$31,473,837
Accommodation and food services	72	824512	11744451	\$190,190,752	100135	4130380	\$77,708,593	724377	7614071	\$112,482,159
Other services (except public administration)	81	3905021	6121087	\$73,832,944	124134	1000942	\$31,498,530	3780887	5120145	\$42,334,414
Industries not classified	99	15970	3716	\$262,048	2123	2544	\$54,870	13847	1172	\$207,178

Note: Dollars in thousands of dollars.

Source: Author's calculations based on U.S. Census data.